DOW THEORY LETTERS INC.

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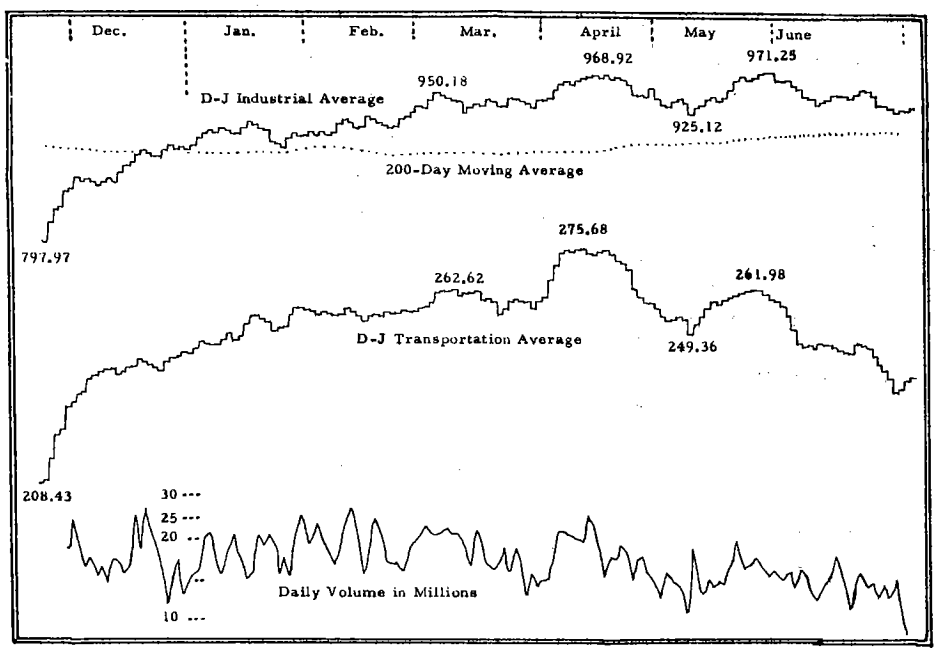
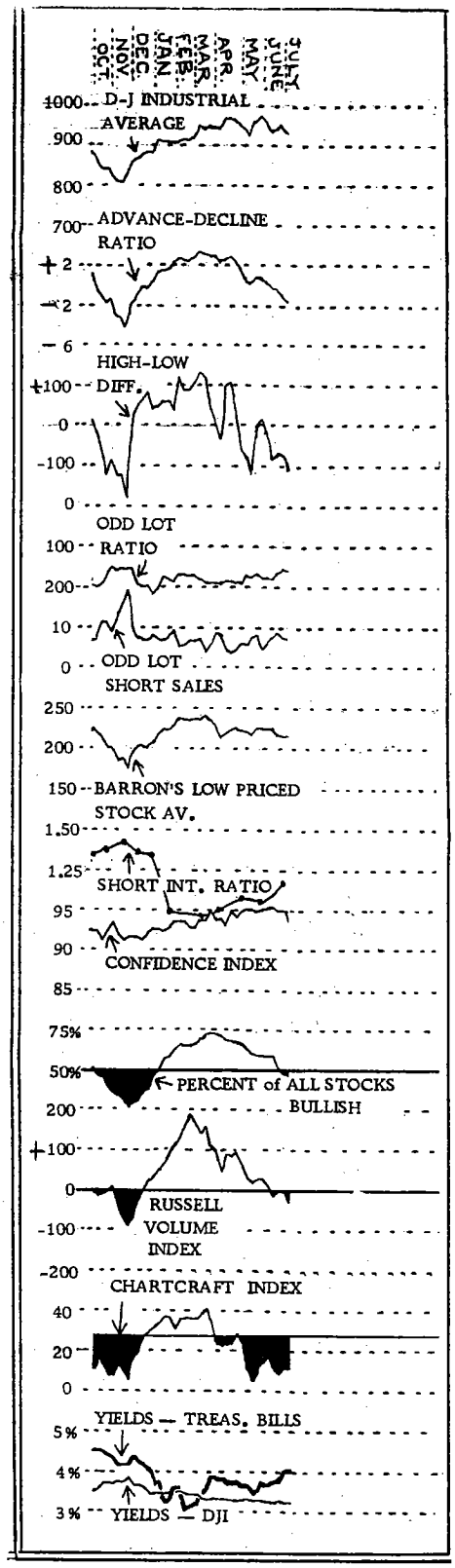
THE MARKET: Last night I saw Kubrick's "A Clockwork Orange." It is a movie which deals with the "ultra-violence" of our times, and the barbarism and insanity which is its natural outgrowth. The world today is spending more than $200 billion a year on arms. The developed nations are not only arming themselves to the teeth, but they are selling vast quantities of arms to the underdeveloped nations. With large segments of the underdeveloped nations' populations in dire need and often actually starving, the last things these countries need are tanks, flame throwers, the latest model rifles and jet planes.

Meanwhile the US is presumably "winding up" the longest war in its history, or rather we are pulling out our land-based combat troops while leaving our Naval and Air Force units so that we may continue systematically to destroy Vietnam with the greatest concentration of explosives ever put together in the history of warfare.

Many years ago Gandhi of India said, "Evil means, even for good ends, produce evil results." And centuries before that, in Ecclesiastes (14) it was written, "I have seen all the works that are done under the sun; and, behold all is vanity, and vexation of the spirit." As if to fulfill these prophecies, it was announced (NY Times, June 23) that the Thieu government of South Vietnam has arrested thousands (4 to 8 thousand) of citizens suspected of "Communist sympathies," and "many (of the arrests) based on nothing more than a single denunciation by a neighbor or acquaintance." Doubtless, most if not all of Thieu's political opposition has been swallowed up in the latest revolting display. This then, is the government for which we have been fighting for years.

Meanwhile, with the collapse of the pound the world is witnessing another of the monetary crises which have become a familiar phenomenon of the late-1960's and early '70's. But this particular crisis seems to possess a ferocity all its own, and it has already heralded the fall of the recent Smithsonian agreements, which, we remember,





 were termed by President Nixon the greatest monetary manifesto "in the history of the world."

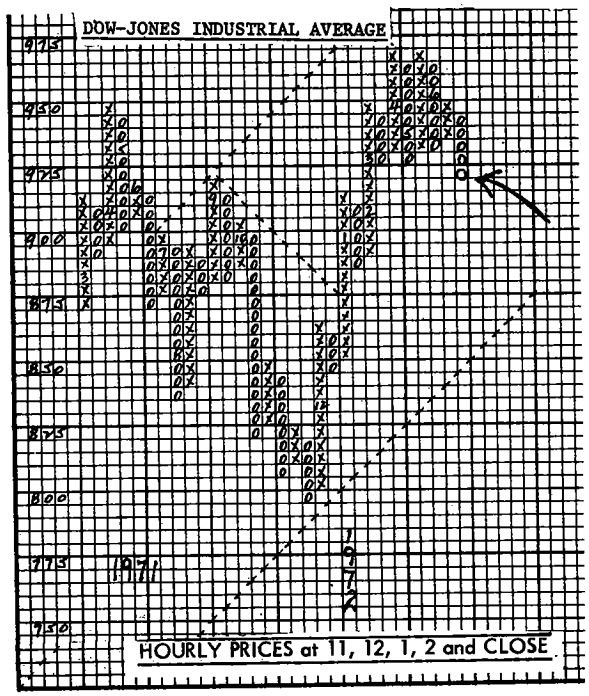
What is coming out of the current mess is something which I have warned about for a long time, and that is exchange controls. Nation after nation is now erecting barriers to the entrance of more dollars past their borders. All of this is calculated, among other things, to bring the dollar down to new lows both in the markets and in the eyes of the world (while producing endless troubles for those engaged in international trade).

A second ominous problem also arises from the new hard European stance, and that is the problem of financing of the US budget deficits. Up to now the Europeans have been literally "buying up our deficits" as they purchased greenbacks by the millions to keep the dollar from tumbling below agreed levels. But as economist Eliot Janeway states it in his latest report (June 28), "From here on out the burden of financing the budget deficit will be on the domestic credit markets. This means that the crisis which has broken the pound is on the verge of breaking the American credit markets as well."

So all in all, with exchange controls, floating currencies and an exploding US debt structure, I can offer three predictions for the coming months (1) higher US interest rates, (2) higher prices for gold, (3) declining value for the dollar on world markets.

And so we turn to the stock market itself, where Wall Street is undoubtedly wrestling with the same problems I have outlined above (together with the added problem of "Will Senator McGovern get the nomination and if so, will he be able to defeat Mr. Nixon?"). Recent Letters have documented the adverse price-breadth relationship, pointing to the ominous "triple divergence" in the advance-decline ratio with three descending peaks in the ratio and the three rising peaks in the Dow (see chart). On May 29 the ratio touched its lowest level since December 2, 1971, at which time the Dow closed at 848.70. Thus the Dow (if it were to align itself with the rest of the market) could easily tumble 70 or more points.

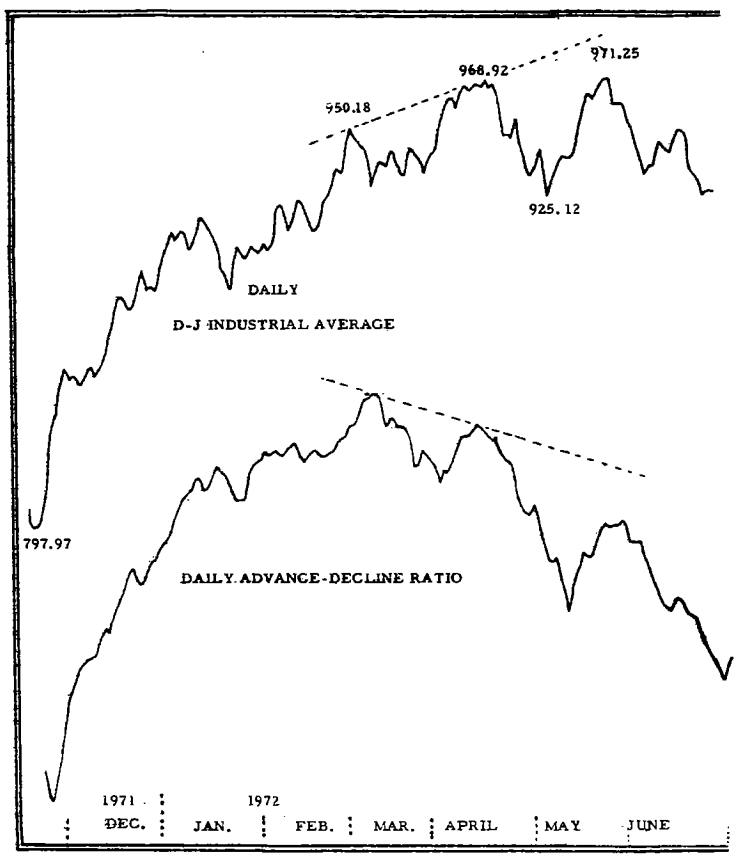
On the same day (May 29) the first point and figure "sell signal" of 1972 was registered when the Dow touched an intra-day hourly figure below 925. This is shown on this 5-point reversal chart (courtesy of Chartcraft, Larchmont, NY 10538). On the chart all rows of X's represent rallies of 15 points or more, all rows of O's denote declines of 15 points or more. Each individual box represents 5 points on the Dow.



I have drawn an arrow at the 925 level, showing where a "triple bottom" (which is P & F language) at the 930 level was penetrated. The chart shows that there is currently no "resistance" until the rising trendline from the 1971 low is met. If the Dow were to continue straight down from here, it would meet the rising (or bullish) 1971 trendline in the 860 area.

The period following the July 4 holiday finds the market in a generally "oversold" condition, and it would therefore be normal for Wall Street to muster up a rally effort in this area. So far, the Dow has resisted penetration of the important May low of 925.12, and I have noted in the last two Letters that this is the critical point in the technical structure of the market.

Following whatever advance attempt we may now witness, the Dow will probably "test" 925.12 again. Refusal to penetrate this level would set the market up for what many like to term "the traditional summer rally." On the other hand, if the rally fizzles and 925.12 is penetrated, the odds are that the summer rally will be just another "no show" for 1972.



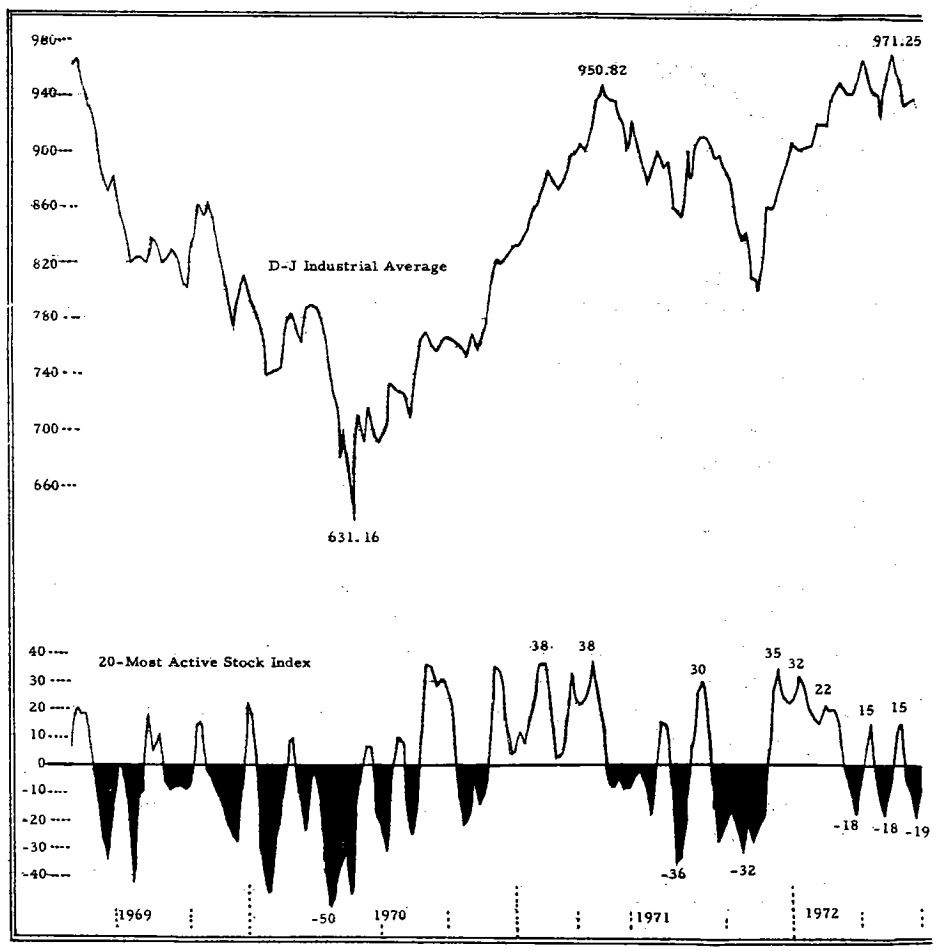
OTHER TECHNICAL POINTS: The percentage of all stocks in bullish trends (see page 1 chart) has now dropped to the 45% level. The Russell Volume Index (60-day differentials of total up and down volume) has dropped to minus 32, lowest level since 1971. Chartcraft's composite of 28 technical indices is down to a reading of 10 (on a scale of zero to 56) with the halfway or "neutral" reading being 28. Yields on the bellwether 91-day Treasury bills rose to just over 4% last week, highest reading of the year. The bill yields should be watched closely from here on. The market can adjust to any given level of yields, but it is always unnerved by a steadily climbing yield level (regardless of from what level that climb began). Note also that the yield spread in favor of bills over the average Dow Industrial yields has widened to .65, widest spread of 1972.

The number of secondary distributions on the NYSE zoomed to 83 in June, largest total in history. Even the Wall Street Journal picked this story up, and it appeared on page 1 of the July 3 issue. Any way you look at it, a secondary is offered by a party who has the brains to accumulate a large block of stock, and the fact that the secondary is offered means that the party would rather have cash than corporate certificates. Prognosis for record total of secondaries — bearish.

WHERE THE ACTION IS: This is a chart which has appeared often in these Letters. It is the "most active stock index" (MASI), and it is tabulated as follows. Each week Barron's lists the 20 most active stocks on the NYSE. I tabulate the plurality of advances or declines. For instance, if,in a given week, 15 stocks advanced, 3 declined and 2 were unchanged the plurality would be a plus 12. These weekly pluralities are then arranged in the form of a 3-week moving average, and that is what I show on the chart.

MASI is significant because the 20 most active stocks usually comprise about 15% to 20% of total NYSE volume on any given week. This "most active" volume is often created by professional and informed speculative activity, and experience shows that the direction of MASI tends to lead the Dow and the rest of the market.

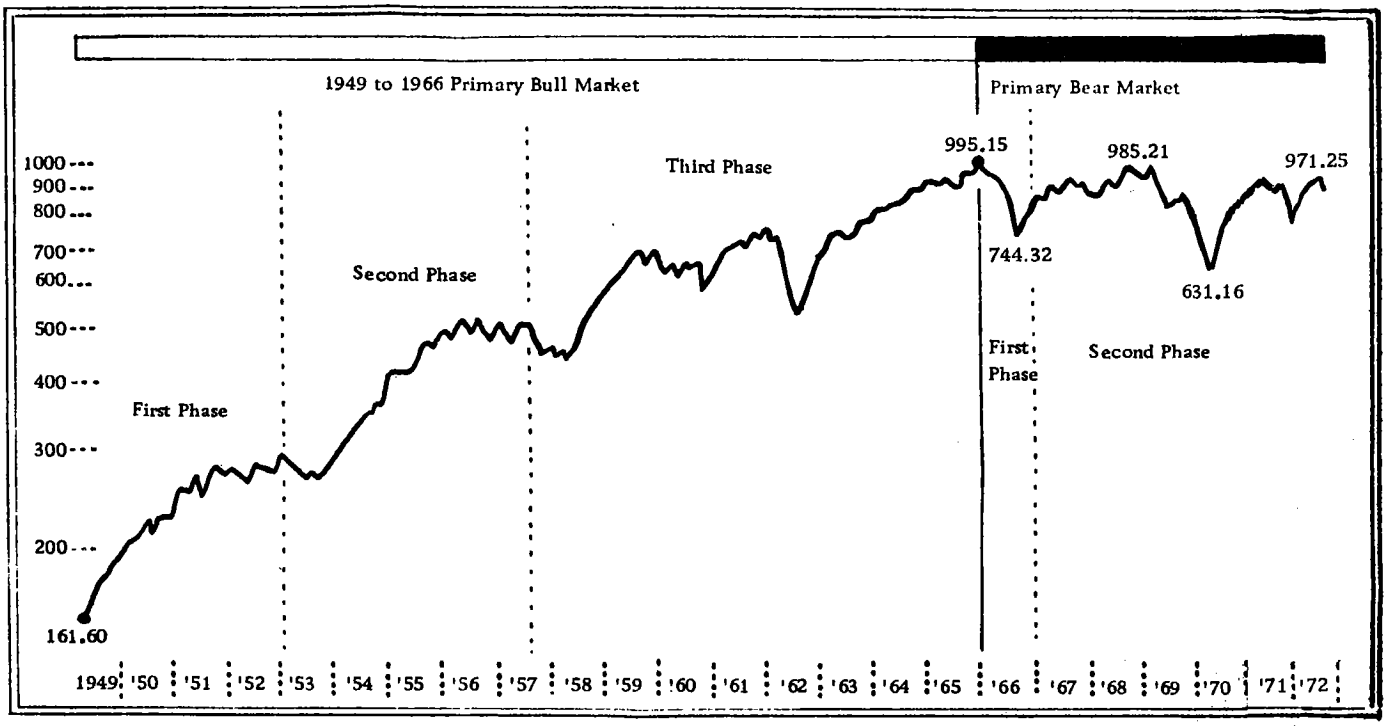
Although I show over three years of activity on the chart, I am only going to review the late-1971 and 1972 action. The peak for MASI came on the week ending December 3, 1971, with an index reading of 35, as seen on the chart. From then on, successive lower peaks marked the path of MASI, despite new recovery highs in the Dow.



On the week ending February 18, 1972, MASI hit a peak of 22; it then plunged to a minus 18 on the last week of March. It is significant that the advance-decline ratio topped out on March 9, then started falling along with MASI. The A-D ratio has been hitting new 1972 lows ever since.

A new rise began for MASI and on April 23 the index recorded a rather weak peak of plus 15. The Dow,during that same week touched a high of 968.92. A second drop in MASI index took it into minus territory, prior to a new rally. On June 3 the index formed a "double top" as it again stalled at plus 15. A few days earlier, on May 26, the Dow had recorded a peak of 971.25.

On the week ending June 23 MASI dropped to a low for the year at minus 19, indicating the distribution in the most active stocks had touched a new high for the year. To me, the most unusual factor in the situation is the preponderance of minus figures in MASI with the Dow still roughly in the area of its 1972 highs. All of which suggests that distribution among the most active issues is intense and is taking place under the guise of "strength" in the Dow Industrials. No wonder Wall Street is frustrated and getting mauled here in mid-1972. The majority of investors are showing losses for all their activity of the past six months (probably longer) and technical deterioration is apparent and growing stronger.



LONG-TERM PERSPECTIVE: Here they are laid out in all their phases and price movements, the primary bull market of 1949 to 1966, and the primary bear market of 1966 to date. Those of us who were operating through the 1949-66 bull market had plenty of chances to scratch our head, pull our hair, and complain about "how tough it is" to follow the trend. This was certainly true during the latter part of the second (psychological) phase of the bull market, encompassing the years 1957 and 1958. If you remember, however, the second phase of any bull or bear market is always the deceptive one, the one that has investors ready to shout "bull market" out of one side of their mouth and "bear market" out of the other.

To review, the first phase of a bull market represents the initial "lift" from the depressed depths of the previous bear market bottom. The second phase represents the expanding-business phase, the one in which the market rises in reflection of better economic, political and social conditions, when profits are on the uphill road. The third and final phase is the speculative one, and it is here that the public makes its entrance (it is also here that the professional distribute the stock which they accumulated during the first two phases). The 1949-66 bull market was extraordinary in that its third or distributive phase was far longer than the other two phases, whereas in all history the third phase has proved to be the explosive but short phase.

Remember, the phases have to do with psychological conditions during markets, not price movements. With this in mind, we come to the primary bear market which began in 1966. The first phase occurred during 1966, and here the Dow suddenly dropped from 995.15 in February to 744.32 in October. This drop was greeted by an all-out opening of the money spigots as a terrified Washington attempted to reverse the primary trend.

The first phase of a primary bear market represents the "erasing" of the foam and froth of the preceding bull market top. But removing the froth was not that easy during 1966, for the US was facing the most furious monetary and economic inflation seen since the Civil War. Nevertheless, prices were hit hard, and I label the first phase as ending around the end of 1966.

The Dow turned up, and by the end of 1968 it had touched 985.21 (closing price). The action of 1967 and 1968 was all part of an extended second phase, and it is the second phase of the primary bear market that we are still in today. During the second (bear market) phase Wall Street reflects the deterioration in the economic, social and political structure of the nation. Here, as in the second bull market phase, we may expect (and are getting) the most deceptive and perplexing price movements.

True to its "deceptive billing", the Dow turned down from its 985.21 peak of 1968, and smashed to a 1970 low of 631.16. It was the worst beating Wall Street had taken since the 1930's. Many individual investors, speculators, hedge funds and marginal corporations went to the wall.

Then we come to the ambitions and "keynesianization" of Mr. Nixon. With the Fed printing money at an astounding rate, with the wholesale and consumer price indices going through the roof, the Administration managed to balloon the Dow up to its May 26, 1972, peak of 971.25. It was a monumental effort, even though the advance-decline ratio indicated that the peak of strength was achieved back in April, 1971.

All of which leaves us staring at the accompanying chart (page 4) with palsied eyes. For despite the ruination of US currency, despite unconscionable inflation, despite a reversal of President Nixon's economic philosophy, we note a series of three descending peaks in the Dow, 995.15 (1966), 985.21 (1968), and 971.25 (1972). We also see a series of two descending bottoms, 744.32 (1966) and 631.16 (1970). Take that any way you want it, history will record the movement (so far) as part of a seven-year primary bear market.

But, you say, the Dow is still within 60 or 70 points of its 1966 high. And that is true. But most stocks are not near their old highs, and the bear market has not yet announced that it is over. So I can only tell my readers that I believe we are now in the continuing, tedious, deceptive second phase of this longest of all bear markets. Remember fellow students, I do not make the market, I only attempt to follow it (and at times out-guess it). And nothing I have in my data or in my charts tells me that the primary bear market is over yet. Until it is, my advice is — "Stay out."

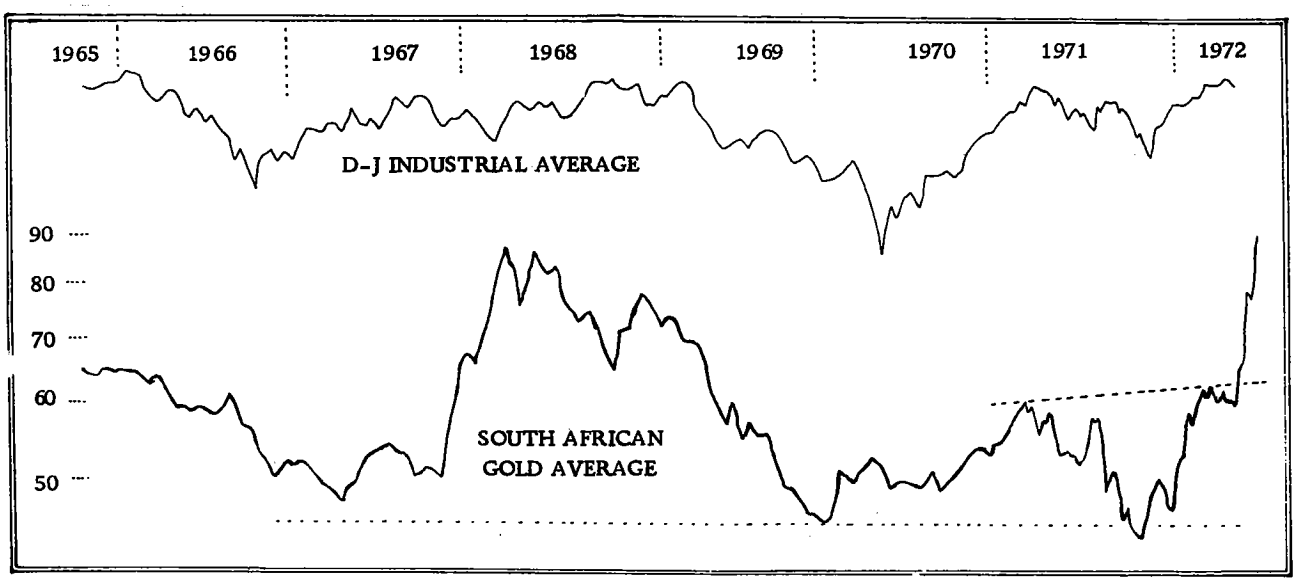
GOLD AND MONEY: To my mind, the most exciting story on Wall Street continues to be gold. And the incredible fact is that Americans have been so conditioned by anti-gold propaganda that here we are, with gold booming to daily new record highs and the gold shares are, in many cases, just moving out of their bases.

On July 5 the price of gold in London closed at a record $66 per ounce (see page 6 gold-silver chart). This out-dates almost all of the profit projections for gold shares, and the question continues to be, at what price will gold ultimately be fixed?

The latest (July) Bank Credit Analyst (1245 Sherbrooke St., West, Montreal, Canada 109) put the whole picture into beautiful perspective, and I want to quote this paragraph: "For it must now be totally obvious to any thinking person that the entire international financial system is on a one-way street to disintegration which will be marked by floating exchange rates, split exchange rates along the French line, complete foreign exchange and trade controls and so on. It must be equally obvious that this trend can only be thwarted by re-introducing an anchor into the international financial system. This anchor can only come from a re-valued gold stock which is the only basis for fixed exchange rates that have a high degree of credibility. This credibility would be restored only if market participants know that there is a large enough gold stock to dominate international capital movements. Such a knowledge would guarantee that speculative capital movements would dry up as new exchange rates would be taken as given. The longer the time before gold is revalued and the dollar made convertible, the higher any new official price of gold would ultimately have to be, in order to provide this credibility."

Perhaps the most dramatic move of the current period is the surge in the S. African issues. The accompanying chart shows the fantastic 1971-72 upsurge in the S. African Gold Average, which includes not only many premium quality issues but many speculative issues as well. Currently, I might add, I like Vaal Reefs, Kloof and Blyvoors for purchase if you are one of my subscribers who has not yet taken a position in gold shares. High yielding S. African issues with less growth characteristics include President Brand and Free State Geduld.

Charts of the S. African golds are hard to come by, and we are fortunate in having P & F charts of the golds from Jim Dines' Paflibe, 18 E. 41 St., NYC 10017. Note that in many and in fact most cases the moves in these issues has just taken them out of major bases. Thus, from a technical standpoint these stocks could have a long way to go on the upside. I also include



Page 6 Dines' chart of American-South African Investment Trust (ASA), a gold holding company listed on the NYSE. This is a premium vehicle for entrance into the S. African gold scene, and note that since 1971 ASA has formed a major "head-and-shoulders" bottom formation. ASA traditionally sells at a premium above its portfolio value, and at present the premium is 16%. When the public gets excited about gold, it would not surprise me to see this premium rise to above 30%.